Report to the Audit Committee

SPELTHORNE BOROUGH COUNCIL

Audit Planning: year ending 31 March 2019

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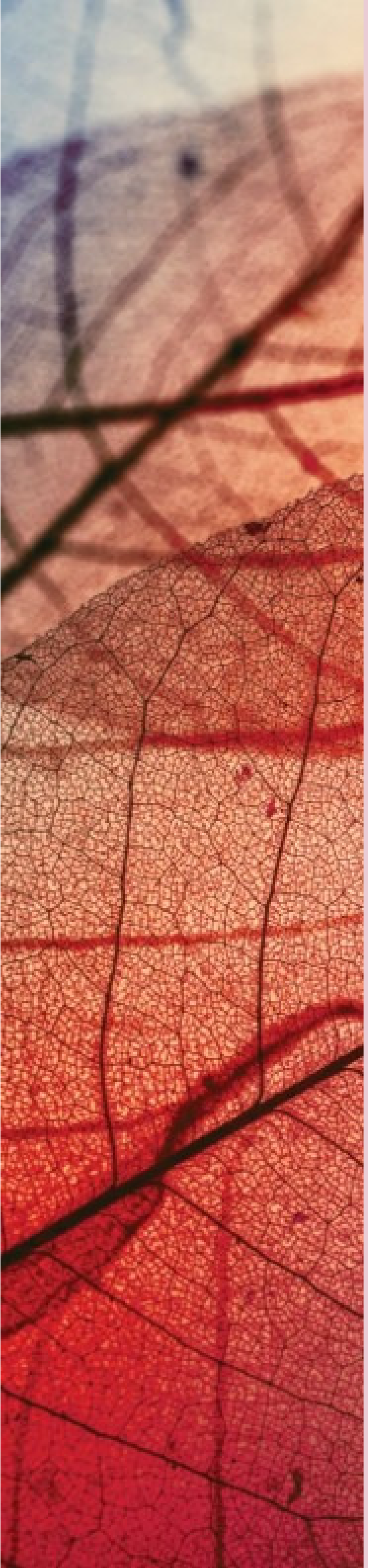
BDO



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WELCOME

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We have pleasure in presenting our Audit Planning Report to the Audit Committee of Spelthorne Borough Council (the 'Council'). This report forms a key part of our communication strategy with you, a strategy which is designed to promote effective two way communication throughout the audit process with those charged with governance.

It summarises the planned audit strategy for the year ending 31 March 2019 in respect of our audit of the financial statements of the Council and consolidated entity (together the 'Group') and use of resources; comprising materiality, key audit risks and the planned approach to these, together with timetable and the BDO team.

The planned audit strategy has been discussed with management to ensure that it incorporates developments in the business during the year under review, the results for the year to date and other required scope changes.

We look forward to discussing this plan with you at the Audit Committee meeting on 28 March 2019 and to receiving your input on the scope and approach.

In the meantime if you would like to discuss any aspects in advance of the meeting please contact one of the team.

L E Lloyd-Thomas

Leigh Lloyd-Thomas

14 March 2019

Leigh Lloyd-Thomas

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SCOPE AND MATERIALITY

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This summary provides an overview of the key audit matters that we believe are important to the Audit Committee in reviewing the planned audit strategy for the Council and the Group for the year ending 31 March 2019.

It is also intended to promote effective communication and discussion and to ensure that the audit strategy appropriately incorporates input from those charged with governance.

Audit scope

The scope of the audit is determined by the National Audit Office (NAO)'s Code of Audit Practice that sets out what local auditors are required to do to fulfil their statutory responsibilities under the Local Audit and Accountability Act 2014. This includes: auditing the financial statements; reviewing the arrangements to secure value for money through the economic, efficient and effective use of its resources; and, where appropriate, exercising the auditor's wider reporting powers and duties.

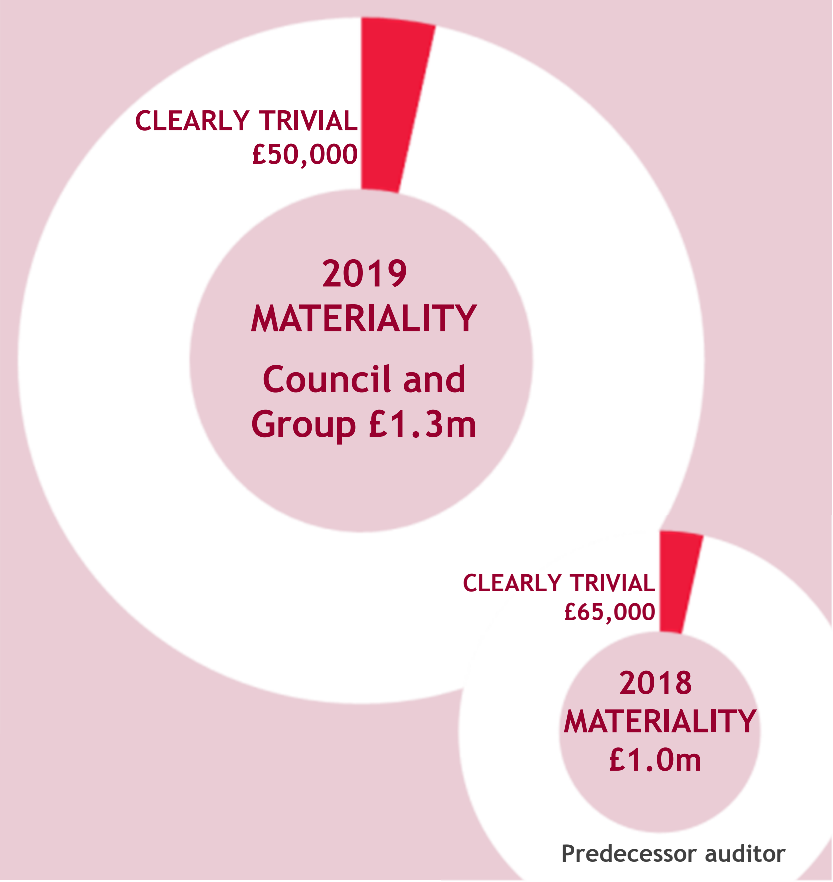
Our approach is designed to ensure we obtain the requisite level of assurance in accordance with applicable laws, appropriate standards and guidance issued by the NAO.

Materiality

Planning materiality for the Council and the Group will be set at 1.5% of gross expenditure for the year (prior year 1.45% by predecessor auditor) using the prior year gross expenditure figure. This will be revisited when the draft financial statements are received for audit.

Although materiality is the judgement of the engagement lead, the Audit Committee is obliged to satisfy themselves that the materiality chosen is appropriate for the scope of the audit.

We usually set our trivial level for reporting misstatements at 2% of materiality (£26,000) although we can set a trivial level up to an upper range at 5% of materiality. We note that your previous auditor set this at 6.5%. We propose capping the trivial level at £50,000 (3.8% of materiality) but will revert to 5% with the approval of the Audit Committee.



AUDIT STRATEGY

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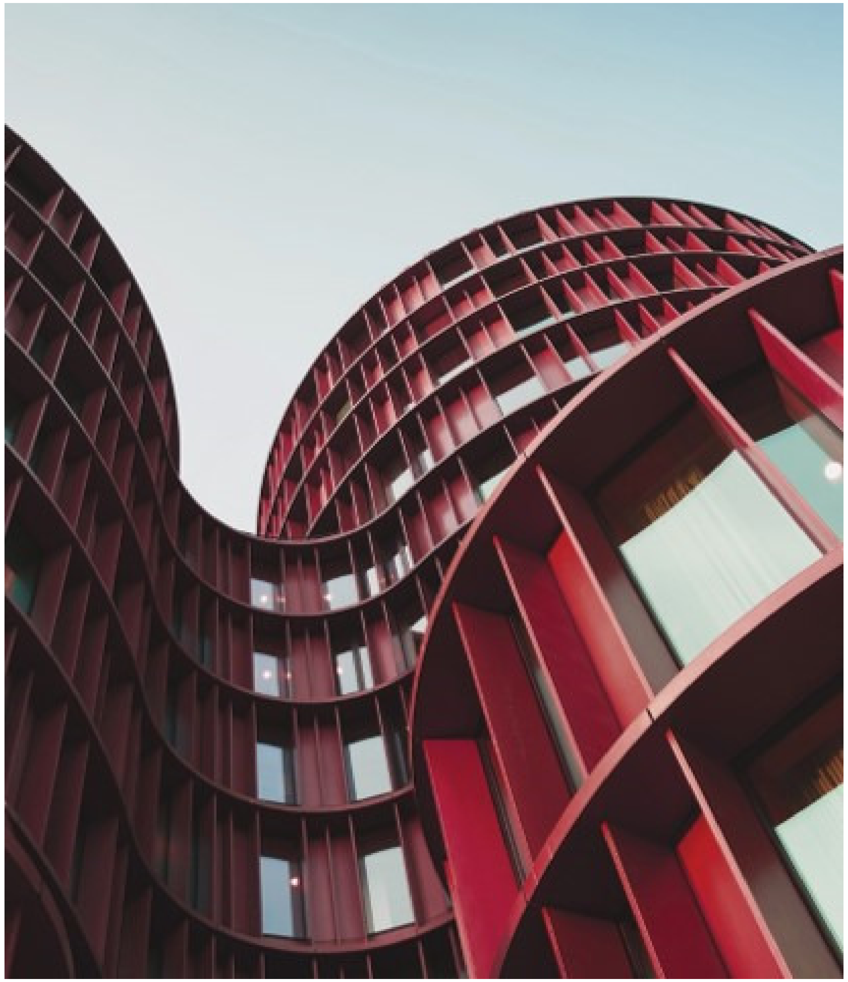

Our Audit Strategy is predicated on a risk based approach, so that audit work is focused on the areas of the financial statements where the risk of material misstatement is assessed to be higher, or where there is a risk that the organisation has not made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

We have discussed the changes to the organisation, systems and controls in the year with management and obtained their own view of potential audit risk in order to update our understanding of the Council and the Group's activities and to determine which risks impact on the numbers and disclosures in the financial statements, or on its arrangements for securing economy, efficiency and effectiveness in its use of resources.

A lower level of materiality is applied to the areas of the financial statements that are considered to be sensitive, such as senior management remuneration disclosures, auditor's remuneration disclosures and related party disclosures.

We will continue to update this assessment throughout the audit.

The table on the next page summarises our planned approach to audit risks identified.

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Risk identified - Financial statements	Risk rating	Fraud risk present	Testing approach	Impact of significant judgements and estimates
1. Management override of controls	Significant	Yes	Substantive	Medium
2. Revenue and expenditure recognition	Significant	Yes	Substantive	Medium
3. Property, plant & equipment and investment properties valuations	Significant	No	Substantive	High
4. Pension liability valuation	Significant	No	Substantive	High
5. Revenue from contracts with customers (IFRS 15)	Significant	No	Substantive	Medium
6. Classification and measurement of financial instruments (IFRS 9)	Significant	No	Substantive	Medium
7. Allowance for non-collection of receivables and debt	Normal	No	Substantive	Medium
8. Related party transactions	Normal	No	Substantive	Low

Risk identified - Use of resources	Risk rating	Testing approach
9. Sustainable finances	Significant	Detailed review
10. Decision making for investment property acquisitions	Significant	Detailed review

INDEPENDENCE AND FEES

Executive summary

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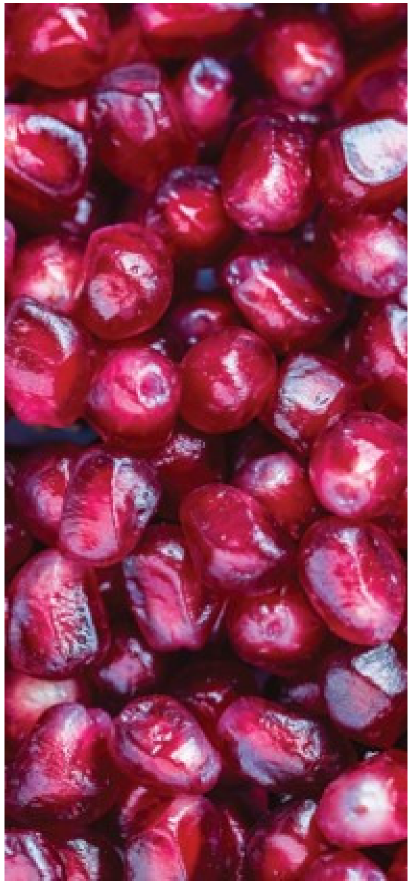

Independence

We confirm that the firm complies with the Financial Reporting Council's Ethical Standard for Auditors and, in our professional judgement, is independent and objective within the meaning of those Standards. We previously drew the Audit Committee's attention to the fact the Council has acquired the freehold interest in a property in Reading in which we currently hold a lease under the terms arranged with the previous owner. We are satisfied that this does not present a threat to our independence and objectivity as your auditor.

Fees

	2018/19 £	2017/18 £
Code audit fees	(1) 41,059	(2) 48,128
Total audit fees	**41,059**	**48,128**
Non audit fees		
Housing benefit subsidy certification	7,102	(2) 7,102
Non audit fees	**7,102**	**7,102**
Total fees	**48,161**	**55,230**

(1) Public Sector Audit Appointments Limited (PSAA) has set the 2018/19 fee scale at £37,059, on the basis that individual fees for all opted-in bodies have been reduced by 23 per cent from the applicable scale fee for 2017/18. This gives opted-in bodies the benefit of the cost savings achieved in the recent audit procurement, and continues the practice of averaging firms' costs so that all bodies benefit from the same proportionate savings, irrespective of the firm appointed to a particular audited body. It also passes on the benefit of economies which PSAA is making in its own operating costs. We have estimated an additional fee of £4,000 for the audit of the Group Accounts, as the consolidated entity is not separately audited. We will re-visit this estimate when we receive the draft accounts and supporting working papers of the subsidiary.

(2) KPMG was the appointed auditor for these audits in 2017/18 and we have reported their planned fees above.

OVERVIEW

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Key components of our audit objectives and strategy are highlighted and explained on the following pages.

Audit planning is a collaborative and continuous process and our audit strategy, as reflected here, will be reviewed and updated as our audit progresses.

We will communicate any significant changes to our audit strategy, should the need for such change arise.

Reporting	Objectives
Auditing standards	We will perform our audit in accordance with International Standards on Auditing UK (ISAs (UK)) and relevant guidance published by the NAO.
Financial statements	We will express an opinion on the Council and Group financial statements, prepared in accordance with the CIPFA Code of Practice on Local Authority Accounting 2018/19 and other directions.
Statement of Accounts	In addition to our objectives regarding the financial statements, we will also read and consider the other information contained in the Statement of Accounts to consider whether there is a material inconsistency between the other information and the financial statements or other information and our knowledge obtained during the audit.
Use of resources	We will report whether we consider that the Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources.
WGA	We will review the Whole of Government Accounts (WGA) return, if above the thresholds set by DWP, and express an opinion on whether the return is consistent with the audited financial statements.
Additional powers and duties	Where necessary we may be required to: issue of a report in the public interest; make a written recommendation to the Council; allow local electors to raise questions and objections on the accounts; or exercise legal powers to apply to the courts for a declaration that an item of account is contrary to law, issue an advisory notice or an application for a judicial review.
Report to the Audit Committee	Prior to the approval of the financial statements, we will discuss our significant findings with the Audit Committee. We will highlight key accounting and audit issues as well as internal control findings and any other significant matters arising from the audit.

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AUDIT SCOPE ENTITIES, COMPONENTS AND AUDIT RISKS

A high-level overview of how we have designed the Group audit strategy is summarised below to ensure you have clear oversight of the scope of the work we intend to perform.

Entity	Nature of Operations	Audit classification	Reason for classification	Audit Risks	Component Materiality	Audit strategy
Spelthorne Borough Council	Provides local authority services	Significant	Size and Risk	Risks 1-10	£1.3m	Statutory audit performed by BDO LLP
Knowle Green Estates Limited	Holding investments in residential property around the borough (100% owned by the Council)	Non significant component Income £282,000 Assets £2.017m (31/3/18 draft accounts)	Size	Risks 3, 5, 6, 7	£1.3m	The company makes use of the exemption from audit under Section 476 of the Companies Act 2006. We will audit the company's material balances. Total income and expenditure in the entity is less than £100,000 after elimination of intra-group transactions, therefore the net impact on the Group financial statements is below our group audit materiality. However, the net assets of the subsidiary are material as the subsidiary holds properties with a material value.

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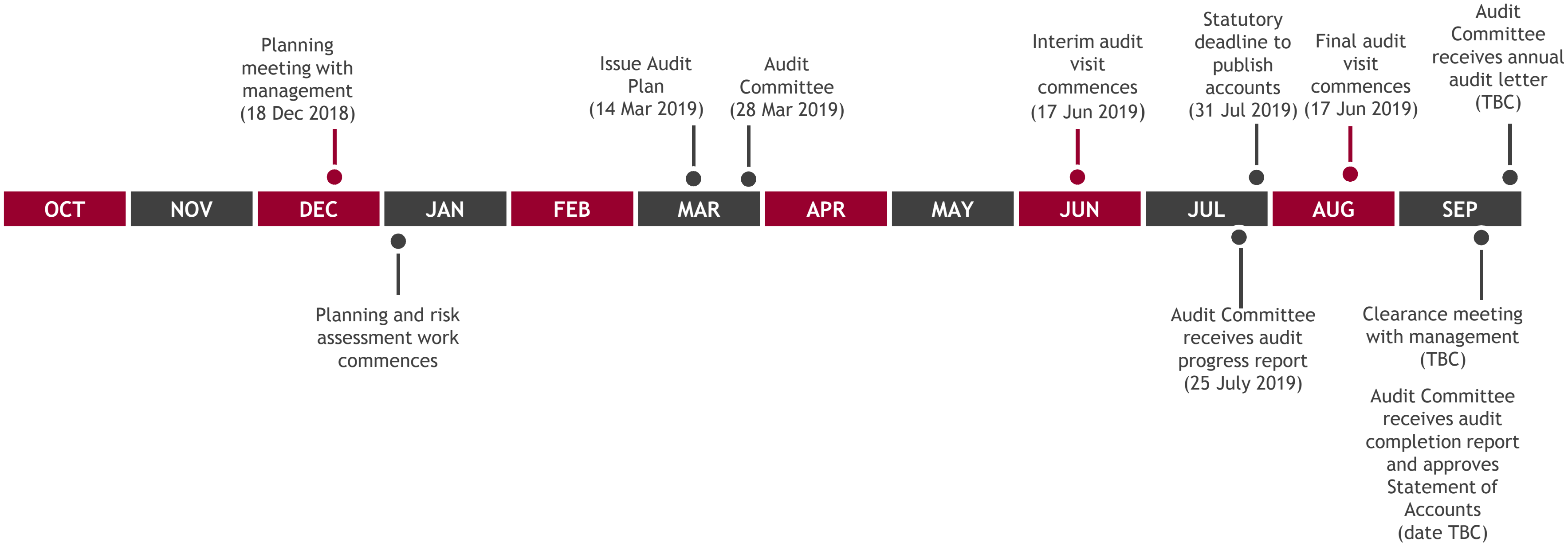
AUDIT TIMELINE

An overview of the key dates



Planning meeting with management (18 Dec 2018)

Issue Audit Plan (14 Mar 2019)

Audit Committee (28 Mar 2019)

Interim audit visit commences (17 Jun 2019)

Statutory deadline to publish accounts (31 Jul 2019)

Final audit visit commences (17 Jun 2019)

Audit Committee receives annual audit letter (TBC)

Planning and risk assessment work commences

Audit Committee receives audit progress report (25 July 2019)

Clearance meeting with management (TBC)

Audit Committee receives audit completion report and approves Statement of Accounts (date TBC)

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Engagement Lead

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As audit engagement lead I have primary responsibility to ensure that the appropriate audit opinions are given.

In meeting this responsibility I ensure that the audit has resulted in obtaining sufficient and appropriate evidence to provide reasonable, but not absolute, assurance that the financial statements are free from material misstatement, whether due to fraud or error, and to report on the financial statements and communicate as required by the ISAs (UK), in accordance with our findings.

I will ensure that we have undertaken sufficient work to assess the Council's arrangements for securing economy, efficiency and effectiveness in the use of its resources against the guidance published by the NAO.

I am responsible for the overall quality of the engagement and am supported by the rest of the team as set out here.

Janine Combrinck

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I will manage the audit of the Council.

I work closely with Leigh to develop and execute the audit strategy. I will be a key point of contact on a day to day basis for the Council and will ensure that timelines are carefully managed to ensure that deadlines are met and matters to be communicated to management and the Audit Committee are highlighted on a timely basis.

Tawanda Mutenga
Audit Senior

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I will lead the on-site audit visits at the Council.

I work closely with Janine to execute the audit strategy. I will provide management support for the audit.

Audit risks

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We have assessed the following as risks for our audit. These are matters assessed as most likely to cause a material misstatement in the financial statements or impact on our use of resources conclusion. These include those risks that will have the greatest effect on audit strategy, the allocation of audit resources and the amount of audit focus by the engagement team.

Description of risk	Significant risk	Normal risk	Overview of risk
1. Management override of controls	🟥		ISA (UK) 240 presumes that management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.
2. Revenue and expenditure recognition	🟥		There is risk in respect of the existence (recognition) of commercial rents and revenue grants that are subject to performance conditions before these may be recognised as revenue. There is also a risk of manipulation of expenditure recognition including expenditure in the following year.
3. Property, plant & equipment and investment properties valuations	🟥		There is a risk over the valuation of land, buildings, dwellings and investment properties where valuations are based on assumptions or where updated valuations have not been provided for a class of assets at year-end.
4. Pension liability valuation	🟥		There is a risk the valuation is not based on appropriate membership data where there are significant changes or uses inappropriate assumptions to value the liability.
5. Revenue from contracts with customers (IFRS 15)	🟥		There is a risk that relevant revenue streams are not recognised in accordance with the '5-step model' of the new accounting standard. There is also the risk that Knowle Green Estates Limited, that report under UK GAAP, may be consolidated into the Group financial statements without the required adjustments to ensure the Group financial statements comply with the new standard.
6. Classification and measurement of financial instruments (IFRS 9)	🟥		There is a risk that relevant financial assets and liabilities are not classified and measured in accordance with the new accounting standard. There is also the risk that Knowle Green Estates Limited, that report under UK GAAP, may be consolidated into the Group financial statements without the required adjustments to ensure the Group financial statements comply with the new standard.
7. Allowance for non-collection of receivables and debt		🟥	There is a risk over the valuation of this allowance if incorrect assumptions or source data are used, or if inappropriate methodology is applied. The implementation of IFRS 9 financial instruments has also changed the basis for estimating losses for non-collection of receivables and debt from an incurred loss model to an expected credit loss model that takes into account assumptions about future credit losses. However, this includes only receivables and debt deemed to be financial instruments and excludes receivables under statute such as council tax and business rates that CIPFA has stated will continue to be accounted for on an incurred loss model.
8. Related party transactions		🟥	There is a risk that related party disclosures are not complete and in accordance with the Code of Practice on Local Authority Accounting requirements.

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Description of risk	Significant risk	Normal risk	Overview of risk
9. Sustainable finances	🟥		There is a risk that the Council may not deliver sufficient savings or generate sufficient additional income to maintain financial sustainability in the medium term.
10. Decision making for commercial property acquisitions	🟥		There is a risk that the Council may not have appropriate arrangements in place to support informed decision making in respect of its commercial property acquisitions.

MANAGEMENT OVERRIDE OF CONTROLS

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ISA (UK) 240 presumes that management is in a unique position to perpetrate fraud.

Significant risk	🟥
Normal risk	
Fraud risk	🟥
Assess design & implementation of controls to mitigate	🟥
Significant Management estimates & judgements	
Controls testing approach	
Substantive testing approach	🟥
Risk highlighted by Council	

Risk detail

ISA (UK) 240 - The auditor's responsibilities relating to fraud in an audit of financial statements requires us to presume that the risk of management override of controls is present and significant in all entities.

Planned audit approach

Our audit procedures will include the following:

- Review and verification of large and unusual journal entries made in the year and agreeing the journals to supporting documentation. We will determine key risk characteristics to filter the population of journals. We will use our IT team to assist with the journal extraction;
- Review of estimates and judgements applied by management in the financial statements to assess their appropriateness and the existence of any systematic bias; and
- Review of unadjusted audit differences for indications of bias or deliberate misstatement.

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REVENUE AND EXPENDITURE RECOGNITION

Under auditing standards there is a presumption that income recognition presents a fraud risk.

Significant risk	■
Normal risk	
Fraud risk	■
Assess design & implementation of controls to mitigate	■
Significant Management estimates & judgements	
Controls testing approach	
Substantive testing approach	■
Risk highlighted by Council	

Risk detail

Under auditing standards there is a presumption that there is a risk of fraud in revenue recognition. In particular, we consider there to be a significant risk in respect of the existence (recognition) of commercial rents income and revenue grants that are subject to performance conditions before these may be recognised as revenue in the comprehensive income and expenditure statement (CIES).

In the public sector the risk of fraud in revenue recognition is modified by Practice Note 10 issued by the Financial Reporting Council. This states that auditors should also consider the risk that material misstatements may occur through the manipulation of expenditure recognition. This risk is identified as being relevant to cut-off of expenditure, where testing will be focussed.

Planned audit approach

Our audit procedures will include the following:

- Testing a sample of commercial rents income to signed lease agreements or other correspondence with the tenant;
- Testing a sample of revenue grants included in income to documentation from grant paying bodies and check whether recognition criteria have been met; and
- Testing a sample of expenditure either side of year end, to confirm that expenditure has been recorded in the correct period and that all expenditure that should have been recorded at year end has been.

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PROPERTY, PLANT & EQUIPMENT AND INVESTMENT PROPERTIES VALUATIONS

There is a risk over the valuation of land, buildings and investment properties where valuations are based on significant assumptions.

Significant risk	■
Normal risk	
Fraud risk	
Assess design & implementation of controls to mitigate	■
Significant Management estimates & judgements	■
Controls testing approach	
Substantive testing approach	■
Risk highlighted by Council	

Risk detail

Local authorities are required to ensure that the carrying value of land, buildings and investment properties is not materially different to the current value (operational assets) or fair value (surplus assets, assets held for sale and investment properties) at the balance sheet date.

Revaluation of non-current assets is carried out on a rolling programme with the exception of investment properties which are valued annually. Valuations are carried out by external RICS qualified valuers.

Due to the significant value of the Council’s land, buildings and investment properties and the high degree of estimation uncertainty, there is a risk over the valuation of these assets where valuations are based on assumptions or where updated valuations have not been provided for a class of assets at the year-end.

Planned audit approach

Our audit procedures will include the following:

- Review of the instructions provided to the valuer and assessing the valuer’s skills and expertise in order to determine if we can rely on the management expert;
- Confirmation that the basis of valuation for assets valued in year is appropriate;
- Review of the accuracy and completeness of asset information provided to the valuer, such as rental agreements and property sizes;
- Discuss with our Real Estate Team the reasonableness of assumptions on benchmark and yields range for investment properties; and
- Review of assumptions used by the valuer and movements against relevant indices for similar classes of assets and follow up on valuation movements that appear unusual.

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PENSION LIABILITY VALUATION

There is a risk the membership data and cash flows used by the actuary in the roll-forward valuation may not be correct, or the valuation uses inappropriate assumptions to value the liability.

Significant risk	■
Normal risk	
Fraud risk	
Assess design & implementation of controls to mitigate	■
Significant Management estimates & judgements	■
Controls testing approach	
Substantive testing approach	■
Risk highlighted by Council	

Risk detail

The net pension liability comprises the Council’s share of the market value of assets held in the pension fund and the estimated future liability to pay pensions administered by Surrey County Council.

An actuarial estimate of the liability is calculated by an independent firm of actuaries. The estimate is based on the roll forward of membership data from the 2016 triennial valuation exercise, updated at 31 March 2019 for factors such as mortality rates and expected pay rises along with other assumptions around inflation when calculating the liability. There is a risk the valuation is not based on appropriate membership data where there are significant changes or uses inappropriate assumptions to value the liability.

Planned audit approach

Our audit procedures will include the following:

- Assess the qualifications and competence of the actuary through the use of PwC consulting actuary (auditor’s expert);
- Review of the reasonableness of the assumptions used by the actuary in the calculation against other local government actuaries and other observable data using the benchmark range of acceptable assumptions provided by PwC consulting actuary (auditor’s expert);
- Review of the controls for providing accurate membership data to the actuary (we will be required to seek assurances from the pension fund auditor); and
- Checking whether any significant changes in membership data have been communicated to the actuary.

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REVENUE FROM CONTRACTS WITH CUSTOMERS (IFRS 15)

There is a risk that revenue from contracts with customers is not measured in accordance with IFRS 15.

Significant risk	
Normal risk	🟥
Fraud risk	
Assess design & implementation of controls to mitigate	
Significant Management estimates & judgements	
Controls testing approach	
Substantive testing approach	🟥
Risk highlighted by Council	

Risk detail

IFRS 15 revenue from contracts with customers has been implemented for 2018/19 and requires all relevant revenue streams to be reviewed under a new ‘5-step model’ to determine the appropriate point at which revenue can be recognised.

CIPFA has published guidance to assist with the required review including what revenue falls within IFRS 15 or IPSAS 23 revenue from non-exchange transactions, and the process for determining the correct recognition points and amounts for revenue. Our initial review of revenue streams for local authorities suggests that there are unlikely to be material restatements required for the Council.

However, the Council will need to undertake a review of all relevant revenue streams to determine the appropriate recognition date and amounts in the financial statements.

This will need to include both the Council and Knowle Green Estates Limited in the Group financial statements, that report under UK GAAP, rather than IFRS, as this new accounting standard has not yet been adopted into UK GAAP.

There is a risk that relevant revenue streams are not recognised in the financial statements in accordance with the new standard. There is also the risk that Knowle Green Estates Limited may be consolidated into the Group financial statements without the required adjustments to ensure the Group financial statements comply with the requirements of the new standard.

Planned audit approach

Our audit procedures will include the following:

- Review of the work performed by the Council, once undertaken, to assess the impact of the new ‘5-step model’ on revenue streams on both the Council and the Group; and
- Review of the disclosures required relating to the adoption of the new accounting standard.

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CLASSIFICATION AND MEASUREMENT OF FINANCIAL INSTRUMENTS (IFRS 9)

There is a risk that financial instruments are not classified and measured in accordance with IFRS9.

Significant risk	
Normal risk	🟥
Fraud risk	
Assess design & implementation of controls to mitigate	
Significant Management estimates & judgements	
Controls testing approach	
Substantive testing approach	🟥
Risk highlighted by Council	

Risk detail

IFRS 9 financial instruments has been implemented for 2018/19 and requires all relevant financial instrument assets (principally investments and loans provided to others) and liabilities (principally borrowing) to be categorised under new criteria based on their business model and contractual cash flows that will determine their classification and basis of valuation.

CIPFA has published guidance to assist with the required review and any restatement required where the classification needs to be amended.

The Council will need to undertake a review of all relevant assets and liabilities to determine the appropriate classification in the financial statements.

There is a risk that relevant financial assets and liabilities are not classified and measured in accordance with the new accounting standard.

Planned audit approach

Our audit procedures will include the following:

- Review of the work performed by the Council, once undertaken, to assess the new classification of financial instruments in accordance with the guidance on both the Council and the Group; and
- Review of the disclosures required relating to the adoption of the new accounting standard.

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ALLOWANCE FOR NON-COLLECTION OF RECEIVABLES AND DEBT

There is a risk over the valuation of the allowance for the non-collection of arrears and debt.

Significant risk	
Normal risk	🟥
Fraud risk	
Assess design & implementation of controls to mitigate	
Significant Management estimates & judgements	
Controls testing approach	
Substantive testing approach	🟥
Risk highlighted by Council	

Risk detail

The Council recognises an allowance for the non-collection of receivables (arrears and debt), primarily in respect of council tax, business rates and housing benefit overpayments. The Council assesses each type of receivable separately in determining how much to allow for non-collection.

There is a risk over the valuation of this allowance if incorrect assumptions or source data are used, or an inappropriate methodology is applied.

The implementation of IFRS 9 financial instruments has also changed the basis for estimating losses for non-collection of receivables and debt from an incurred loss model to an expected credit loss model that takes into account assumptions about future credit losses. However, this includes only receivables and debt deemed to be financial instruments and excludes receivables under statute such as council tax and business rates that CIPFA has stated will continue to be accounted for on an incurred loss model.

Planned audit approach

Our audit procedures will include the following:

- Review of the provision model for significant income streams and receivables and debt balances to assess whether it appropriately reflects historical collection rates by age of debt or arrears;
- Check that information has been accurately extracted from systems to support the modelling of collection rates by age; and
- For receivables classified as financial instruments, includes appropriate assumptions for expected credit losses.

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RELATED PARTY TRANSACTIONS

There is a risk that related party disclosures are not complete and in accordance with the Code of Practice on Local Authority Accounting 2018/19 requirements.

Significant risk	
Normal risk	■
Fraud risk	
Assess design & implementation of controls to mitigate	■
Significant Management estimates & judgements	
Controls testing approach	
Substantive testing approach	■
Risk highlighted by Council	

Risk detail

Whilst you are responsible for the completeness of the disclosure of related party transactions in the financial statements, we are also required to consider related party transactions in the context of fraud as they may present greater risk for management override or concealment of fraud. Our audit approach includes the consideration of related party transactions throughout the audit including making enquiries of management and the Audit Committee.

There is a risk that related party disclosures are not complete and in accordance with the Code of Practice on Local Authority Accounting requirements.

Planned audit approach

Our audit procedures will include the following:

- Review of management processes and controls to identify and disclose related party transactions;
- Review of relevant information concerning any such identified transactions;
- Discussing with management and reviewing councillors’ and management declarations to ensure that there are no potential related party transactions which have not been disclosed; and
- Undertaking Companies House searches for potential undisclosed interests.

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SUSTAINABLE FINANCES

There is a risk that the Council may not deliver sufficient savings or generate sufficient additional income to maintain financial sustainability in the medium term.

Significant risk	■
Normal risk	
Fraud risk	
Assess design & implementation of controls to mitigate	■
Significant Management estimates & judgements	
Controls testing approach	
Detailed review	■
Risk highlighted by Council	

Risk detail

The Council has set a Medium Term Financial Strategy (MTFS) covering the period 2019/20 to 2022/23. Due to reducing grant funding and ongoing cost pressures, the current MTFS indicates the following budget gaps if no mitigating actions are put in place: £3.506 million in 2020/21, £4.209 million in 2021/22 and £1.971 million in 2022/23.

The Council has identified efficiency savings and the delivery of additional income, through investment property acquisitions and its housing delivery programme, as a means to address the budget gaps in the MTFS. The achievement of these targets are inherently challenging and there is a risk that the MTFS may not fully take account of the investment costs associated with major capital and development projects.

Planned audit approach

Our audit procedures will include the following:

- Assessment of the reasonableness of assumptions underpinning the MTFS, including the cost pressures and the amount of Government grant reductions applied;
- Monitoring the delivery of the budgeted savings in 2018/19 and the plans to reduce services costs and increase income from 2019/20; and
- Determining whether the MTFS adequately takes account of investment costs associated with major capital and development projects.

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DECISION MAKING FOR COMMERCIAL PROPERTY ACQUISITIONS

There is a risk that the Council may not have appropriate arrangements in place to support informed decision making in respect of its commercial property acquisitions.

Significant risk	🟥
Normal risk	
Fraud risk	
Assess design & implementation of controls to mitigate	🟥
Significant Management estimates & judgements	
Controls testing approach	
Detailed review	🟥
Risk highlighted by Council	

Risk detail

The Council has embarked on a sizeable programme of commercial property acquisitions, with the aim of generating significant investment income to reduce the budget gaps in its MTFS. In 2018/19 to date, the Council has spent £314 million in purchasing five commercial properties.

Due to the large scale of the acquisitions, there is an inherent risk that there may not be appropriate arrangements in place to support fully informed decision making in respect of these acquisitions.

Planned audit approach

Our audit procedures will include the following:

- Review of the audit trails underpinning each major commercial property acquisition in 2018/19, and making enquiries of officers where necessary, to assess whether decisions have been adequately informed by appropriate arrangements such as options appraisal, risk assessment, sensitivity analysis and treasury management considerations.

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OTHER MATTERS REQUIRING FURTHER DISCUSSION

Fraud

Whilst the Audit Committee, as those charged with governance, has ultimate responsibility for prevention and detection of fraud, and councillors have a duty to ensure there are adequate controls to reduce losses to fraud and corruption, we are required to obtain reasonable assurance that the financial statements are free from material misstatement, including those arising as a result of fraud. Our audit approach includes the consideration of fraud throughout the audit and includes making enquiries of management and those charged with governance.

We have been made aware of a number of low value actual, alleged or suspected incidences of fraud committed by users of the Council's services (such as housing benefits fraud). We request confirmation from the Audit Committee on fraud and a discussion on the controls and processes in place to ensure timely identification and action.

Significant estimates

We will report to you on significant estimates. We will seek to understand and perform audit testing procedures on accounting estimates and judgements including consideration of the outcome of historic judgements and estimates. We will report to you our consideration of whether management estimates and judgements are within an acceptable range.

Internal audit

We will ensure that we maximise the benefit of the overall audit effort carried out by internal audit and ourselves, whilst retaining the necessary independence of view.

We understand that internal audit reviews have been undertaken across a range of accounting systems and governance subjects. We will review relevant reports as part of our audit and consider whether to place any reliance on internal audit work as evidence of the soundness of the control environment.

Laws and regulations

We will consider compliance with laws and regulations. The most significant of these for your business includes VAT legislation and employment taxes. We will make enquiries of management and review correspondence with the relevant authorities.

Accounting policies

We will report to you on significant qualitative aspects of your chosen accounting policies. We will consider the consistency and application of the policies and we will report to you where accounting policies are inconsistent with CIPFA’s Code of Practice on Local Authority Accounting 2018/19, applicable accounting standards or other direction under the circumstances.

Financial statement disclosures

We will report to you on the sufficiency and content of your financial statement disclosures.

Contingencies

We request input from management on any recent claims.

Any other matters

We will report to you on any other matters relevant to the overseeing of the financial reporting process. Where applicable this includes why we consider a significant accounting practice that is acceptable under the financial reporting framework not to be the most appropriate.

IT GENERAL CONTROLS

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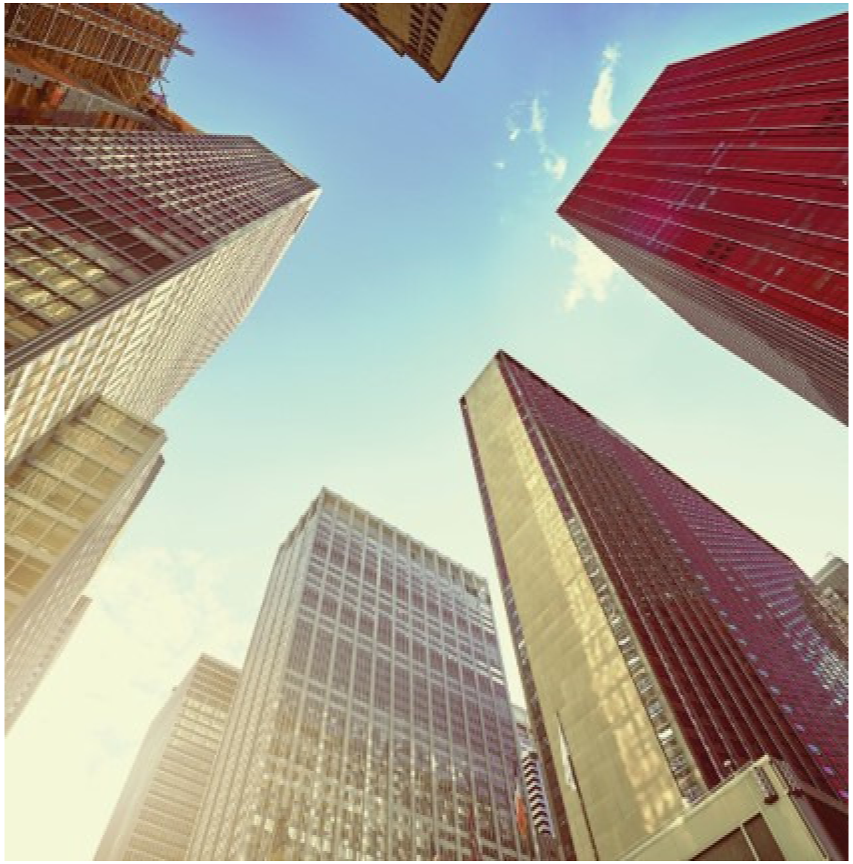
IT General Controls (ITGCs) are the policies and procedures that relate to many IT applications and support the effective functioning of application controls by helping to ensure the continued proper operation of information systems. They commonly include controls over data centre and network operations; system software acquisition, change and maintenance; access security; and application system acquisition, development, and maintenance.

ITGCs are an important component in systems of internal control, and sometimes have a direct impact on the reliability of other controls.

IT assurance is embedded in our audit strategy to ensure the IT systems provide a suitable platform for the control environment and is undertaken in conjunction with our IT Assurance team. Our testing strategy includes a tailored range of data analytics, system configuration and IT environment testing.



INDEPENDENCE

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Under ISAs (UK) and the FRC's Ethical Standard we are required, as auditors, to confirm our independence.

We have embedded the requirements of the Standards in our methodologies, tools and internal training programmes. Our internal procedures require that audit engagement partners are made aware of any matters which may reasonably be thought to bear on the integrity, objectivity or independence of the firm, the members of the engagement team or others who are in a position to influence the outcome of the engagement. This document considers such matters in the context of our audit for the year ending 31 March 2019.

Non-audit services

Details of services and fees other than audit, provided by us to the Council during the period and up to the date of this report are set out in the appendices.

Long association and rotation of staff

Details of rotation arrangements for key members of the audit team and others involved in the engagement are set out in the appendices.

Commercial relationships

We previously drew the Audit Committee's attention to the fact the Council has acquired the freehold interest in a property in Reading in which we currently hold a lease under the terms arranged with the previous owner.

We are satisfied that this does not present a threat to our independence and objectivity as your auditor as this commercial relationship is at arms length, the audit team are not party to the lease negotiations and the amounts are not material to either party.

We have not identified any other relationships or threats that may reasonably be thought to bear on our objectivity and independence.

We confirm that the firm, the engagement team and other partners, directors, senior managers and managers conducting the audit comply with relevant ethical requirements including the FRC's Ethical Standard and are independent of the Council.

We also confirm that external audit experts involved in the audit comply with relevant ethical requirements including the FRC's Ethical Standard and are independent of the Council and the Group.

Should you have any comments or queries regarding any independence matters we would welcome their discussion in more detail.

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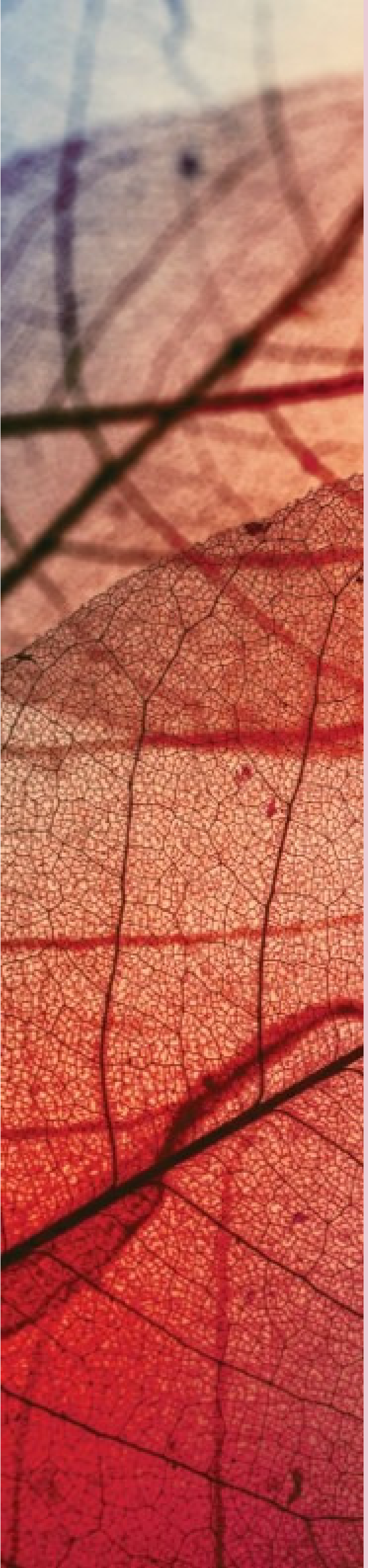
Fees summary for year ending 31 March 2019

	2018/19 £	2017/18 £
Code audit fees	(1) 41,059	(2) 48,128
Total audit fees	**41,059**	**48,128**
Non audit fees		
Housing benefit subsidy certification	7,102	(2) 7,102
Non audit fees	**7,102**	**7,102**
Total fees	**48,161**	**55,230**

(1) Public Sector Audit Appointments Limited (PSAA) has set the 2018/19 fee scale at £37,059, on the basis that individual fees for all opted-in bodies have been reduced by 23 per cent from the applicable scale fee for 2017/18. This gives opted-in bodies the benefit of the cost savings achieved in the recent audit procurement, and continues the practice of averaging firms' costs so that all bodies benefit from the same proportionate savings, irrespective of the firm appointed to a particular audited body. It also passes on the benefit of economies which PSAA is making in its own operating costs. We have estimated an additional fee of £4,000 for the audit of the Group Accounts, as the consolidated entity is not separately audited. We will re-visit this estimate when we receive the draft accounts and supporting working papers of the subsidiary.

(2) KPMG was the appointed auditor for these audits in 2017/18 and we have reported their planned fees in the table.



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COUNCIL’S RESPONSIBILITIES

The Council’s Responsibilities and Reporting

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Financial reporting

The Council is expected to have effective governance arrangements to deliver its objectives. To this end, the publication of the financial statements is an essential means by which the Council accounts for its stewardship and use of the public money at its disposal.

The form and content of the Council’s financial statements, and any additional schedules or returns for consolidation purposes, should reflect the requirements of the relevant accounting and reporting framework in place and any applicable accounting standards or other direction under the circumstances.

The Council is also required to prepare schedules or returns to facilitate the preparation of consolidated accounts such as HM Treasury’s Whole of Government Accounts.

The Section 151 Officer is responsible for preparing and filing a Statement of Accounts and financial statements which show a true and fair view in accordance with CIPFA’s Code of Practice on Local Authority Accounting 2018/19, applicable accounting standards or other direction under the circumstances.

Our audit of the financial statements does not relieve management nor those charged with governance of their responsibilities for the preparation of the financial statements.

Use of resources

Councils are required to maintain an effective system of internal control that supports the achievement of their policies, aims and objectives while safeguarding and securing value for money from the public funds and other resources at their disposal.

As part of the material published with its financial statements, the Council is required to bring together commentary on its governance framework and how this has operated during the period in a governance statement.

In preparing its governance statement, the Council will tailor the content to reflect its own individual circumstances, consistent with the requirements of the relevant accounting and reporting framework and having regard to any guidance issued in support of that framework. This includes a requirement to provide commentary on their arrangements for securing value for money from their use of resources.

OUR RESPONSIBILITIES

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Our responsibilities and reporting - financial statements

We are responsible for performing our audit under International Standards on Auditing (UK) to form and express an opinion on your single-entity and consolidated financial statements. We report our opinion on the financial statements to the members of the Council.

We read and consider the ‘other information’ contained in the Annual Report such as the additional narrative report. We will consider whether there is a material inconsistency between the other information and the financial statements or other information and our knowledge obtained during the audit.

Our responsibilities and reporting - use of resources

We are required to satisfy ourselves that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

This means that we have regard to relevant guidance issued by the NAO and undertake sufficient work to be able to satisfy ourselves as to whether the Council has put arrangements in place that support the achievement of value for money.

What we don’t report

Our audit is not designed to identify all matters that may be relevant to the Council and the Audit Committee and cannot be expected to identify all matters that may be of interest to you and, as a result, the matters reported may not be the only ones which exist.

COMMUNICATION WITH YOU

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Those charged with governance

References in this report to 'those charged with governance' are to the Council as a whole. For the purposes of our communication with those charged with governance you have agreed we will communicate primarily with the Audit Committee.

Communication, meetings and feedback

We request feedback from you on our planning and completion report to promote two way communication throughout the audit process and to ensure that all risks are identified and considered; and at completion that the results of the audit are appropriately considered. We will meet with management throughout the audit process. We will issue regular updates and drive the audit process with clear and timely communication, bringing in the right resource and experience to ensure efficient and timely resolution of issues.

Planning report

The planning report sets out all planning matters which we want to draw to your attention including audit scope, our assessment of audit risks and materiality.

Internal controls

We will consider internal controls relevant to the preparation of financial statements in order to design our audit procedures and complete our work. This is not for the purpose of expressing an opinion on the effectiveness of internal control.

Audit completion report

At the conclusion of the audit, we will issue an audit completion report to communicate to you key audit findings before concluding our audit opinion. We will include any significant deficiencies in internal controls which we identify as a result of performing audit procedures. We will meet with you to discuss the findings and in particular to receive your input on areas of the financial statements involving significant estimates and judgements and critical accounting policies.

Once we have discussed the contents of the audit completion report with you and having resolved all outstanding matters we will issue a final version of the report.

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These tables indicate the latest rotation periods normally permitted under the independence rules for the terms of appointment by PSAA.

In order to safeguard audit quality we will employ a policy of gradual rotation covering the team members below as well as other senior members of the engagement team to ensure a certain level of continuity from year to year.

Independence - engagement team rotation

Senior team members	Number of years involved	Rotation to take place before
Leigh Lloyd-Thomas Engagement lead	1	5 years
Janine Combrinck Project manager	1	10 years

MATERIALITY: DEFINITION AND APPLICATION

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Concept and definition

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to monetary misstatements but also to disclosure requirements and adherence to appropriate accounting principles and statutory requirements.

We apply the concept of materiality both in planning and performing our audit, and in evaluating the effect of misstatements. For planning, we consider materiality to be the magnitude by which misstatements, including omissions, could influence the economic decisions of reasonable users that are taken on the basis of the financial statements. In order to reduce to an appropriately low level the probability that any misstatements exceed materiality, we use a lower materiality level, performance materiality, to determine the extent of testing needed. Importantly, misstatements below these levels will not necessarily be evaluated as immaterial as we also take account of the nature of identified misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements as a whole.

Materiality therefore has qualitative as well as quantitative aspects and an item may be considered material, irrespective of its size, if it has an impact on (for example):

- Narrative disclosure e.g. accounting policies, going concern
- Instances when greater precision is required (e.g. senior managers remuneration and related party transactions).

International Standards on Auditing (UK) also allow the auditor to set a lower level of materiality for particular classes of transaction, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Calculation and determination

We have determined materiality based on professional judgement in the context of our knowledge of the Council, including consideration of factors such as industry developments, financial stability and reporting requirements for the financial statements.

We determine materiality in order to:

- Assist in establishing the scope of our audit engagement and audit tests;
- Calculate sample sizes; and
- Assist in evaluating the effect of known and likely misstatements on the financial statements.

Reassessment of materiality

We will reconsider materiality if, during the course of our audit engagement, we become aware of facts and circumstances that would have caused us to make a different determination of planning materiality if we had been aware.

Further, when we have performed all our tests and are ready to evaluate the results of those tests (including any misstatements we detected) we will reconsider whether materiality combined with the nature, timing and extent of our auditing procedures, provided a sufficient audit scope.

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If we conclude that our audit scope was sufficient, we will use materiality to evaluate whether uncorrected misstatements (individually or in aggregate) are material.

You should be aware that any misstatements that we identify during our audit, both corrected and uncorrected errors, might result in additional audit procedures being necessary.

Unadjusted errors

We will communicate to you all uncorrected misstatements identified during our audit, other than those which we believe are 'clearly trivial'.

Clearly trivial is defined as matters which will be of a wholly different (smaller) order of magnitude than the materiality thresholds used in the audit, and will be matters that are clearly inconsequential, whether taken individually or in aggregate.

We will obtain written representations from the Audit Committee confirming that in their opinion these uncorrected misstatements are immaterial, both individually and in aggregate and that, in the context of the financial statements taken as a whole, no adjustments are required.

We will request that you correct all uncorrected misstatements. In particular we would strongly recommend correction of errors whose correction would affect compliance with contractual obligations or governmental regulations. Where you choose not to correct all identified misstatements we will request a written representation from you setting out your reasons for not doing so and confirming that in your view the effects of any uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as whole.

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BDO's audit quality cornerstones underpin the firm's definition of audit quality.

BDO is committed to audit quality. It is a standing item on the agenda of the Leadership Team, who in conjunction with the Audit Stream Executive, monitors the actions required to maintain a high level of audit quality within the audit stream and address findings from external and internal inspections. We welcome feedback from external bodies and are committed to implementing necessary actions to address their findings.

We recognise the importance of continually seeking to improve audit quality and enhancing certain areas. Alongside reviews from a number of external regulators, the firm undertakes a thorough annual internal Audit Quality Assurance Review and as a member firm of BDO International network we are also subject to a quality review visit every three years. We have also implemented additional quality control review processes for all listed and public interest entities.

More details can be found in our Transparency Report at www.bdo.co.uk

MINDSET

- Scepticism
- Independent
- Focus on the shareholder as user
- Robustness and moral courage.

KNOWLEDGEABLE, SKILLED PEOPLE

- Knowledge of the business
- Intelligent application of auditing standards
- Intelligent application of accounting standards
- Understanding of the control environment.

AUDIT QUALITY CORNERSTONES

- How to assess - benchmarking
- Where to focus - risk-based approach
- How to test - audit strategy
- What to test - materiality and scope.

DILIGENT PROFESSIONAL JUDGEMENTS

- Audit reports
- Management letter
- Audit Committee Reports
- Top quality financial statement.

HIGH QUALITY AUDIT OUTPUTS

FOR MORE INFORMATION:

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